

# DUE DILIGENCE STEP-BY-STEP GUIDE

## OVERVIEW

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### WHAT IS DUE DILIGENCE?

In reference to Global Development Alliances (GDAs), due diligence refers to the actions USAID takes to evaluate the risks and benefits of working with a potential private sector partner. GDA partners contribute resources as opposed to receive USAID funding, so they are not subject to the usual due diligence investigation completed through the procurement process as part of a responsibility determination. Because of this gap, Missions must complete a separate due diligence investigation (documented in a due diligence memorandum) on the partner before entering into a formal partnership with them<sup>1</sup>. Under GDA due diligence there are a total of five essential areas for investigation—corporate image, social responsibility, environmental accountability, financial soundness, and policy compatibility—that comprise the suggested dimensions for responsible due diligence.

Corporate Image	Social Responsibility	Environmental Accountability	Financial Soundness	Policy Compatibility
Public image Pending lawsuits Negative media Transparency	CSR policy Labor Standards Health and Safety Code of Conduct	Monitoring Mitigating impact Improving performance	Publically traded Annual reports Audited financials Years in business	Excluded Parties List Agency Policies Foreign Affairs Sensitivities

### WHY DO IT?

Due diligence cuts down on unpleasant surprises and reduces the chance that the business practices of a partner will reflect poorly on USAID and its implementing partners, and on the U.S. Government. It reveals which partners have a proven and recognized commitment to principled business practices and should give USAID some information by which to decide whether to rely on a private sector partner's non-binding commitment for providing resource support for an activity. Due diligence will not typically provide a yes or no answer to the question: should we partner with a particular entity? Instead, the due diligence should document research and analysis conducted for the benefit of the Agency official who will be making the decision to enter into a partnership. The due diligence memorandum should provide a recommendation, based on the risks that have been identified, as to whether an alliance should be pursued with the potential partner.

### WHEN SHOULD IT BE DONE AND BY WHOM?

Due diligence should:

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<sup>1</sup> AAPD 04-16, Public Private Alliance and Collaboration Agreement, outlines the difference between due diligence and responsibility.

- Be conducted on all potential resource partners (those partners that contribute resources to a partnership with USAID); however, it is not typically conducted on implementing partners, such as NGOs or contractors.
- Begin as soon as negotiations with partners progress beyond the “getting to know you” stage, and continue on an ongoing basis for as long as the relationship exists. The due diligence should be presented to the Agency official who will decide whether to enter into the partnership well before serious partnership negotiations begin.
- Be conducted by the USAID mission or Washington office that is negotiating the partnership. Any time an agreement with a partner is amended or renewed, an update to the due diligence is advised.

## WHAT ARE THE STEPS INVOLVED?

Since due diligence is such a crucial part of the partnering process, serious attention must be given to the topic before embarking on a partnership. Planning is essential, as it may take some time to gather appropriate information, consult subject matter and policy experts, analyze the information, and provide answers to questions and concerns from the Agency official deciding whether to enter into the partnership. Technical offices conducting the due diligence may need to consult with the Regional Legal Advisor, OAA shop, and Program Office early in the process to develop a good approach to conducting the due diligence in a particular case. The breadth and scope of the due diligence review should be comprehensive and should consider the five areas noted above. Remember, though, that it may not be necessary to investigate every possible avenue of consideration, particularly for small alliances. Due diligence memos should generally follow this outline, but should be modified to fit any specific topics or risks that arise.

### STEP 1: PLANNING

Plan the due diligence steps so that the work can be completed well before partnership discussions are too far advanced. For private sector partners that present immediate concerns, it may be helpful to consult with the Regional Legal Advisor/General Counsel, Contracting Officer/OAA, Program Office, or other office to plan an efficient approach toward conducting the due diligence and determine which individuals should clear/review the due diligence memo.

Consider the kinds of questions that will need to be answered for the particular due diligence analysis (see Step 3). If particular areas of inquiry are going to be a focus, the information gathering stage can be tailored appropriately.

### STEP 2: GATHER INFORMATION

#### Getting help

1. **Gather Information.** The first step in due diligence is to gather information. Search news articles, company reports and subscription-only resources, such as Dun & Bradstreet, Lexis-Nexis, Factiva and others.
2. **Risk Metrics Sustainability Reports.** GDA has a subscription to Risk Metrics, which provides independent sustainability analysis and reports on large, multinational companies. To request a Risk Metrics report search, contact [gda@usaid.gov](mailto:gda@usaid.gov).
3. **GDA Database.** Find out where USAID has worked with the potential partner in other regions or in the past by searching the GDA database online.

4. **Other Web Searches.** Conducting other searches on the Web may tap into sources that are not described above. Be sure to conduct searches in the local language as well. Be sure to weigh the source of the information when considering the content of the information.
5. **Agency and US Government Policy.** Also be sure to check USAID, State and other US government resources to see if there are particular issues concerning the private sector partner's particular business sector, relationship with a particular country, government, or client, or other policy concern. In some situations, you may want to investigate the top managers or board members of a particular company. This could potentially include doing a search involving sensitive information to determine if the individual is eligible for a visa to the US, which is one way to identify risks to the agency.

### **Supplement and verify with local sources**

Internet-based searches will only give you limited information. It is important to contact local sources for information about the company. Talk to the following individuals/organizations to get a clearer picture of the company's performance and reputation locally/regionally:

- US Embassy Commercial Services Officer: usually a wealth of business intelligence
- Potential partners' current customers, suppliers, and/or private sector or government partners
- Local press
- Relevant local associations and American Chamber of Commerce
- Consider asking the company directly for information, such as annual reports, etc.

### **STEP 3: ANALYZE THE INFORMATION GATHERED**

IDEA/GP has prepared a list of questions that can serve as a guide toward identifying particular issues that the Agency official deciding whether to enter the partnership must consider. It is not necessary to answer each question in the due diligence memo. The purpose of the questions is to help the researcher make sure they have covered all the major areas of due diligence.

### **STEP 4: DRAFT DUE DILIGENCE MEMO**

The analysis may result in red flags that will either suggest the partnership is not advisable or must be considered carefully before further discussions can take place with the potential partner. Mission or Operating unit personnel involved with pursuing the partnership and the Agency official, who will be deciding ultimately whether to enter the partnership, should be kept informed and involved in deciding whether input from USAID/Washington is needed.

*What do you do if the due diligence turns up issues?*

Given the size and scale of the company or the economic environment in which these companies operate, it is likely that some issues will surface. At this point, an analysis of the materiality of the issue must be undertaken, and in the end, a judgment call must be made. Conducting the information gathering and analysis early in the partnership discussion process will go a long way toward preventing programming delays or embarrassment resulting from USAID's need to pull out of a potential partnership at the last minute. Subject matter and policy experts within the operating unit, USAID/Washington, State Department, and other entities can assist in advising decision makers on whether to enter into an alliance, but ultimately the operating unit authorized to plan and implement

activities weighs the risks against the benefits and decides whether to enter the alliance. In the case of alliances that result in MOUs, the USAID signatory to the MOU must make this determination. In the case of collaboration agreements, the agreement officer makes this determination.

### *Drafting the Memo*

Present the due diligence memo to the Agency official who will ultimately decide whether to enter into the partnership/sign the partnership MOU and provide a copy to the cognizant contract or agreement officer. The memo should be completed and reviewed by the Agency deciding official well before serious alliance discussions begin with the potential partner.

## **STEP 5: ONGOING DUE DILIGENCE**

The due diligence process does not end with the signing of the MOU. Actions or issues involving GDA partners can pose a risk to USAID at any point during a partnership. It is recommended that Missions and Operating Units complete an annual update to the due diligence; identifying any new issues that might affect USAID's involvement in the partnership.

# **DUE DILIGENCE RESEARCH QUESTIONS**

## **A. CORPORATE IMAGE**

1. Has there been anything in the media that would reflect negatively upon the company? If so, how has the company dealt with significant negative publicity?
2. Are there any pending lawsuits against the company?
3. Is the company looking solely for PR opportunities by aligning itself with USAID?
4. Is the company only or primarily looking for procurement opportunities or money from USAID?
5. Is the company willing to engage with USAID in a transparent manner without expecting an exclusive relationship (i.e., barring competitors)?
6. Is the company willing to accept limitations on the publicity (i.e., press and media coverage) of the alliance so as to ensure that USAID is not perceived to be endorsing the company or its products and services?

## **B. SOCIAL RESPONSIBILITY**

1. Is the company primarily involved in tobacco or the manufacture or sale of firearms or narcotics, i.e., involvement in these activities constitutes a significant share of company's total portfolio?
2. Does the company have a good reputation (no serious red flag issue areas), especially in areas of corporate social responsibility (CSR)? In the case of new companies or companies with past CSR troubles, are they committed to instituting/improving a sound CSR policy?
3. Does the company have policies barring harmful child labor or forced labor?
4. Does the company have a non-discrimination policy governing the hiring and promotion of minorities, women?

5. Is the company accepting of unions or attempts to organize a union?
6. Does the company have a health and safety action plan for workers, including the handling of hazardous materials and the prevention of environmental accidents?
7. Does the company have a policy for codes of conduct, labor standards?

#### **C. ENVIRONMENTAL ACCOUNTABILITY**

1. Does the company collect and evaluate adequate and timely information regarding the environmental, health, and safety impacts of their activities?
2. Does the company set targets for improved environmental performance, and regularly monitor progress toward environmental, health, and safety targets?
3. Does the company assess, and address in decision-making, the foreseeable environmental, health, and safety-related impacts associated with the processes, goods and services of the enterprise over their full life cycle? And provide the public and employees with adequate and timely information on the potential environment, health and safety impacts of the activities of the enterprise?
4. Does the company maintain contingency plans for preventing, mitigating, and controlling serious environmental and health damage from their operations, including accidents and emergencies; and mechanisms for immediate reporting to the competent authorities?
5. Does the company continually seek to improve corporate environmental performance, by encouraging, where appropriate, the adoption of technologies and operating procedures in all parts of the enterprise that reflect environmental best practices? Are its products or services designed to have no undue environmental impacts, be safe in their intended use, and be efficient in their consumption of energy and natural resources? Can they be reused, recycled, or disposed of safely.

#### **D. FINANCIAL SOUNDNESS.** (Reminder: When USAID is not providing funding to the private sector partner, due diligence does not rise to the level of making a responsibility determination).

1. Does the company appear to have the resources needed to fulfill its commitment in a non-binding agreement to support USAID programs?
2. Is the company publically traded and does it issue annual reports with audited financials?
3. Does the company have a long track record (how many years has it been in business)?
4. Does the company structure appear to be stable? In some cases in the past, corporate restructuring has led to the elimination of a company's CSR division.

#### **E. POLICY COMPATIBILITY.**

1. Is the company subject to US government sanctions?
2. Is the company involved in activities, countries, governments, business sectors, or customers that would cause a reasonable person to believe that USAID is acting inconsistently with its own or US government policy?

# MITIGATING REPUTATION RISK FAQs

As Missions enter into the due diligence process, there are a number of different actions that can be taken with the information uncovered. The purpose of the following FAQs is to provide further guidance on how Missions can still form strategic partnerships if issues arise.

## **Can I enter a GDA that benefits USAID's private sector partner's business interest? What if my partners stand a chance of gaining a direct financial reward as a result of their alliance with USAID?**

Yes, USAID may enter such an alliance, provided a legitimate development purpose exists and the USAID investment is carefully selected. However, U.S. Government funds may never be used to directly engage in profit-making. USAID mitigates its risk in alliances that present the potential for partners to profit by clearly establishing development objectives, by defining how such an alliance best achieves the expected results, and by investing in a facilitating mechanism via a civil society partner.

For example, a U.S. agribusiness firm stood to benefit financially from the creation of a processing plant. To facilitate the project—which was given high priority by the local government, also a partner in the alliance—USAID funded research at a national agricultural research institute in order to identify viable sugarcane strains for the project area. As an alliance partner, the agribusiness firm used the research to complete its due diligence and to secure capital financing. In this case, allowing the agribusiness firm the prospect of financial benefit was determined to be a reasonable trade-off, considering no other industry players were willing to take the risk of establishing in-country growing and processing of this specific commodity. Further, the alliance project is expected to meet and exceed economic growth objectives by creating more than 3,000 new jobs and by stimulating growth in a new industry sector in which the country may have comparative advantage.

If alliance builders deem it necessary to further distance USAID from any potential controversy regarding the earning of income by an alliance partner, they might consider requiring the reinvestment of profit as “program income” to be used for follow-up activities. Depending on the nature of the alliance, this may be facilitated by using standard provisions for program income in the grant to the nongovernmental organization implementing partner.

Of note, the U.S. Trade and Development Agency (USTDA), which promotes U.S. commercial interests and host-country development objectives in developing and middle-income countries, requires U.S. firms receiving USTDA grants to reimburse part or all of USTDA's funding if an individual project is implemented and if the company receives substantial economic benefit. These commitments are included in a letter agreement between USTDA and the company. Alliance builders might consider how such an arrangement could be applicable in a USAID GDA setting.

## **Can USAID help finance the creation of a profit-making enterprise as part of an alliance, such as a processing plant?**

Yes, provided a legitimate development purpose exists. For example, after exploring multiple investment alternatives, USAID could enter into an alliance to aid in the financing or building of a processing plant or operation. As noted earlier, however, U.S. Government funds can never be used to directly engage in profit-making. Thus no profit may be retained by the profit-making enterprise

during the life of the assistance award. An alliance of this sort would require a specific plan to avoid profit-making during the life of the award or a mechanism to reprogram profits during the life of the award.

A familiar scenario for this type of GDA has arisen in agriculture-based economies which are attempting to move from a grow-harvest-export model to a grow-harvest-process-export model in order to capture greater economic value in-country. Often, local private sector capital is not available and few private sector firms are willing to risk starting such operations due to poor business infrastructure.

In determining how best to approach such situations, alliance builders should first explore investment options outside of financing the actual plant. Critical questions to consider include:

- Can alliance funds be used in a facilitative way to address finance impediments or business infrastructure improvements?
- Rather than investing in the actual building of the plant, can USAID funds be used to add legitimacy to the project in order to secure financing, such as in providing market research? Is there another way to draw in private or multi-development bank financing?

If USAID monies—implemented through a capable NGO—are to be used in the actual building or financing of a plant, what is the plan for complying with profit restrictions (as described above), for mitigating against reputation risk, and for avoiding potential negative effects in the marketplace?

- What is the plan for “reinvesting” program income or profit during the life of the assistance award?
- What is the plan for transferring ownership after the plant is built and before it engages in profit-making activities?
- How will you ensure broad enterprise ownership by key stakeholders—especially local stakeholders?
- What is the exit strategy, so that investment in an actual plant is a one-time intervention?
- What is the plan for stimulating growth in related sectors, such as supply chain participants?
- How do we prevent picking a winner or creating a monopoly?

In short, alliances of this sort are technically possible, but alliance builders must plan well to comply with the law, avoid reputation risk, reprogram any potential profits during the life of the assistance, and ensure equitable ownership once the project is complete.

### **Can I enter an exclusive alliance with a private sector partner, rather than opening it up to multiple private sector players in a given industry?**

Prior to the submission of a formal alliance application, alliance builders are free to explore potential alliances (exclusively or not) with any private sector entity. Once a formal application is submitted, then the standard process for unsolicited applications is to be followed.

In some situations, a private sector entity may be interested in entering an exclusive GDA with USAID as a **resource partner**. While alliance builders should explore the inclusion of other private sector players, a single private sector alliance of this sort is acceptable, provided a programmatic need exists and proper due diligence is conducted. However the Mission should make every effort not to guarantee any exclusivity other than a ‘first mover advantage’. Additionally, if a potential partner is

adamant about this being a condition of partnership, consider negotiating a time limited exclusive relationship or limit it to a particular geographic location.

In other situations, a for-profit partner might possess a unique skill, technology, or capability that is of particular programmatic and development interest to USAID, but from the partner's perspective would require an exclusive GDA. In a clean water alliance, for example, USAID agreed to limit for-profit participation to only one partner. This partner had invested heavily in researching and developing a proprietary technology for the elimination of waterborne diseases, even though market demand was questionable. No other competitor had developed a product based on the same technology. Because it was a key programmatic goal for USAID to test new and potentially far-reaching technologies for water purification, it was determined that an exclusive-type GDA with this partner was a reasonable trade-off (i.e. there was only one for-profit alliance partner).

In such exclusive GDAs, USAID mitigates risk by investing in the alliance through a civil society partner, rather than in the for-profit enterprise itself. In such cases, the reputations and skills of civil society partners take on additional importance in adding credibility to the alliance. Strong civil society partners add transparency and focus efforts on institutional reform and on stimulating local competition. In the example above, USAID funded an outside implementing partner to conduct market research and to purchase product from the previously mentioned company.

Alliance builders may accept exclusive-type applications and enter into exclusive-type alliances, but significant programmatic need should exist to exclude other for-profit entities, particularly if USAID decides to fund the for-profit enterprise directly. In most exclusive GDA cases, however, USAID mitigates risk by investing in a civil society partner, rather than in the for-profit enterprise itself.

### **Can USAID promote or purchase a specific product or brand via a GDA?**

The U.S. Government cannot promote, endorse, or market a particular product or entity.

However, under certain conditions, alliance builders might fund the market testing of a particular product or technology and even facilitate the purchase of a specific product through grant funds.

In the case of the water alliance mentioned in the previous section, USAID funds were used to buy and test market a product—the only product of its kind on the market—via an outside actor. Because this partner possessed predominant capability—no competitors had developed a competing product based on the same technology—purchase competition was waived. Without paying for this specific product (via a grant to civil society partner), USAID would not have been able to test the technology in target countries and the partner would not have done it on its own without a more promising business case.

Before endorsing or appearing to endorse a specific product through an alliance, alliance builders should exhaust other available options. Typically, broad mechanisms exist to create market demand or to identify technical solutions to development problems. One alliance built generic demand for higher quality mosquito nets by facilitating broad manufacturer participation via a quality seal program. In this case, several industry participants signed on to the alliance, since they stood to influence the standards to their favor.

**If USAID funds research as part of a GDA, who retains patent or property rights as a result of the funding? Can USAID select an alliance partner to commercialize the technology, patent, or intellectual property?**



As a general rule, USAID retains a non-exclusive, irrevocable license to use intellectual property developed with USAID funds. However, specific rules vary according to intellectual property type (i.e., patent vs. copyright) and recipient (e.g., university vs. NGO research organization, etc.). For specific guidance on USAID rights retained, first look to the standard provisions of the contemplated agreement, then contact your Contracting Officer or legal advisor for further information.

In some GDA circumstances, it makes sense for USAID to fund the research or development of intellectual property at a research institution, with a private sector partner agreeing to purchase commercial rights (from the research institution) in order to market the technology or product. In a vaccine alliance, for example, USAID funded research at a research institution to identify a vaccine to address a life-threatening disease inflicting livestock. A partner agreed to purchase commercialization rights and to market the product. Considering the significant costs associated with commercializing the vaccine and the important development impact, it was a reasonable trade-off for USAID to fund research that would be purchased by the commercial sector partner on an exclusive basis in targeted markets.

### **Are there any industries USAID should never enter an alliance with?**

It is not wise for USAID to enter alliances with organizations whose reputation would adversely affect the overall mission of USAID or specific activities, regardless of the industry. In all cases, USAID alliance builders should conduct adequate due diligence based on the aforementioned guidelines. Certainly, the nature of their core businesses will heavily influence the CSR objectives of prospective partners.

### **Are there any circumstances under which USAID could enter alliances with subsidiaries or joint ventures (JV) of companies with which we have due diligence concerns?**

Circumstances are conceivable under which USAID would enter an alliance relationship with a subsidiary, sister company, or JV of a company with which we have due diligence concerns. For instance, a well-known partner in a USAID alliance is a subsidiary of a company with which USAID has due diligence concerns. This alliance partner is one of several corporate alliance partners that have an interest in promoting the production and marketing of a commodity and in improving market access and income for small-scale producers.

In this alliance and others like it, USAID alliance builders mitigate the risk to USAID's reputation by:

- Assessing the extent to which the prospective partner is committed to CSR. What other programs is the company implementing to improve its CSR track record?
- Defining the particular development value the prospective partner brings to the alliance.
- Structuring the alliance so that it has broad appeal across the targeted sector. Having participation by several industry players will mitigate the effects of one partner with potentially damaging corporate relationships.
- Clearly understanding the nature of business relationships. How many degrees of separation exist between the offending company and your potential partner? How integrated are the companies? What is the potential for a public relations disaster? Are there ways to structure the deal to mitigate exposure of potentially damaging relationships? Being able to answer these questions and respond to them in a persuasive way is critical to knowing whether to enter an alliance of this nature.